to

Arizona Corporation Commission

INDEPENDENT MONITOR'S FINAL REPORT
ON
TRACK B SOLICITATION

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FINAL REPORT OF ACCION GROUP, INC.,
INDEPENDENT MONITOR
IN THE
TRACK B SOLICITATION

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I. EXECUTIVE SUMMARY OF RESULTS

As a result of the solicitations for power supplies conducted by Arizona Public Service Company (APS) and Tucson Electric Power (TEP) pursuant to Decision No. 65743 of the Arizona Corporation Commission (ACC), five contracts have been executed that will provide approximately 1900 MW of summer peaking capacity in 2003, 1975 MW of summer peaking capacity in 2004 and 2005, and 1825 MW of summer capacity in 2006, including peaking capacity.

APS executed three contracts; one with Pinnacle West Energy for 1700 MW of capacity during the third quarter of 2003 and the 4-month summer seasons (June through September) of 2004 through 2006, one with PPL Energy Plus for 112 MW of capacity during the third quarter of 2003 escalating to 150 MW in the summers of 2004 and 2005, and one with Panda Gila River for up to 450 MW of capacity during various non-summer periods during 2003 through 2005. APS has estimated that these contracts will provide power at costs that are approximately $70 million less than the cost of alternative comparable power supplies that could have been procured in open market transactions, and represented the most economic combination of offers available to it.

TEP executed two contracts; one with PPL Energy Plus for 37 MW of capacity in 2003 and for 75 MW of capacity in 2004 through 2006, and one with Panda Gila River for 50 MW during 2003 through 2006. These were the only bidders that offered TEP supplies at prices that were competitive with open market prices. TEP estimates that

these contracts were executed at prices that were lower than the prices of comparable power supplies available in the open market. As a result, TEP estimates that its power supply costs will be between $1 million and $2.5 million less than they would have been over the 2003 through 2006 period, had TEP acquired those products in the open market at the time it conducted its Request for Proposal (RFP).

Accion Group, Inc., which served as the Independent Monitor during this Solicitation, believes that APS and TEP have each carried out a fair, reasonable, transparent (within the bounds of good commercial practice) and effective procurement process. This observation is based on the manner in which the process was conducted, the evaluation processes used to select the winners of the competition, and the access provided us to information and personnel. Our role as Independent Monitor throughout the process provided us with ample opportunity to observe, influence and assess the way in which the process was designed and executed. We observed, and frequently commented on, the process design, the development of the key documents (data presentations, RFPs, pro-forma contracts, etc.) and the selection of evaluation criteria. We also reviewed the evaluation processes employed, the elimination of bids, and the selection of winners. Below, we briefly list the major observations that led us to this general assessment.

- **Open process**. Each utility expended significant effort in making the procurement widely known. This included: identifying entities that would have the greatest lkelihood of being interested and able to provide the services requested, direct contact with every member of this set of suppliers to confirm their knowledge of the Solicitation, creation of an electronic mechanism to quickly and efficiently communicate with

interested parties, and conducting multiple stakeholders' meetings as required.

- **Clarity**. The initial contact documents provided clear and complete information on the services requested, the conditions of a conforming bid, the utilities' operating requirements and transmission limitations, and the information that each utility required from, and would provide to, bidders.
- **Complete information**. Each utility provided any potential bidder complete data on its load history and forecasts. It also answered any questions posed to it and published the answers for all other entities. This information was made readily available via each utility's web site.
- **Credit risk allocation**. Both utilities established credit criteria tailored to meet their individual risk management standards. Those criteria, which varied depending on the credit rating established for each potential bidder, addressed the credit limits and collateral requirements that TEP or APS would require from any bidder and the credit support either utility would provide to any successful supplier. The credit requirements were appropriately developed, provided an appropriate level of protection to each utility, and were administered in a fair and flexible manner.
- **Flexibility**. Both APS and TEP demonstrated a willingness to consider the concerns of bidders and potential bidders. Both provided RFP and pro forma contracts in draft form for comments and suggested changes before the formal initiation of the procurement process. During the evaluation process, each utility contacted bidders that had not submitted conforming bids to investigate ways in which any deficiencies might be cured in a

manner consistent with good commercial practices and the bidders concerns, but still comply with the Solicitation's conditions.

- **Inclusive evaluation process**. In an effort to maximize the number of successful bidders, the evaluation process was designed to have only a minimum number of non-negotiable conditions A bid did not advance to full evaluation only if the bid fee was not paid. All bids meeting that condition were evaluated to determine if the bidder was technically capable of providing the service. The remaining evaluation factors were applied on a consistent basis in order to distinguish among bids. All of the evaluation criteria were clearly articulated in the RFP.
- **Successful outcome**. APS received more than 175 bids from 10 bidders and TEP evaluated 26 bids from 5 bidders. Based on the number of bids received, we believe that the process produced competitive prices for the products purchased.

As previously noted, the process resulted in two supply contracts for TEP – the first with PPL Energy Plus, LLC for 37 MW in 2003 and for 75 MW in 2004 through 2006, and the second with Panda Gila River, LC for 50 MW of June through September on peak capacity in 2003 through 2006. APS contracted for 1700 MW of July through September 2003 capacity and for 1700 MW of June through September 2004 through 2006 capacity from Pinnacle West Energy Corp., and for 112 MW of capacity from PPL Energy Plus LLC for July through September of 2003 and for 150 MW of capacity for the periods June through September of 2004 and 2005. Additionally, APS executed a contract with Panda Gila River LC for

up to 450 MW of capacity for various non-summer month periods during 2003, 2004 and 2005.

While TEP will still have an unhedged capacity position for the summer of 2003 even after executing the contracts described above, the open position is relatively small and we are advised that TEP has already begun negotiations to acquire its remaining unmet need through both bilateral contracts and open market purchases.

APS has, as a result of this Solicitation, contracted for all of its anticipated summer 2003 capacity needs and will only require a limited amount of capacity to meet its summer 2004 anticipated needs.

Both companies recognize that in future years additional resources will be needed and are prepared to acquire those resources through appropriate procurement procedures including subsequent competitive solicitations similar to this Track B process, bilateral contracts and open market purchases.

- **Credible outcome**. The way the process was carried out, from initiation to completion, we saw no effort to advantage or disadvantage any competitor. The lengths that each utility went to in order to attract and retain as large a number of active bidders as possible provide support for this condition. Sixty (60) companies were contacted by APS while TEP contacted 55. Ten presented formal bids to APS and six submitted bids to TEP. In total, more than 200 individual bids were submitted offering more than 3400 MW of capacity to meet Arizona's peak load in 2003 and more than 4100 MW of capacity to meet load in 2005.

II. INTRODUCTION

ACC Decision No. 65743 directed that APS and TEP solicit for power supplies to meet their unmet needs through a competitive process referred to as "the Track B Solicitation" (Solicitation), and "to test the market in this Solicitation beyond the amount of required power that cannot be produced from their respective existing assets or existing contracts," in order to evaluate all alternative supply options, and to assess any beneficial impacts on air and water quality of those alternatives. Decision at 15. The Solicitation was also intended to "further the goal of encouraging the development of a robustly competitive wholesale generation market in Arizona." Id. To assure compliance with the Commission Decision, the ACC Staff (the Staff) appointed Accion Group, Inc. to serve as an Independent Monitor with responsibilities to observe the Solicitation processes implemented, to report on the results achieved, and to assist in the Staff's efforts to ensure that the Solicitation was conducted fairly.

As directed in the Decision, absent evidence of abuse, the utility was responsible for preparing the Solicitation and conducting the Solicitation process. Acquisition of energy and capacity to meet the needs of customers remained the responsibility of the utility, and each utility was required to use accepted business standards for acquiring these resources, as it would when it buys all other products used in providing service.

In order for the Solicitation to attract wide participation, the process had to be accepted by participants as fair, open and transparent. To achieve this, prospective bidders and interested persons who agreed to keep certain information confidential had the opportunity to review supporting data and draft documents in advance of the RFP, the solicitation approach chosen by both utilities, being distributed to bidders. Many bidders and other interested persons provided comments to the utilities, the

Independent Monitor or the Staff regarding the completeness or quality of the information provided. Bidders and interested parties also provided comments to the utility, the Independent Monitor or the Staff regarding the process being employed or the decisions made regarding execution of the Solicitation process.

Bidders had the opportunity to review non-restricted information used by the utility in preparation for the Solicitation, as well as draft RFP and other Solicitation materials, before the Solicitation was released. Bidders provided comments to the utilities and the Independent Monitor regarding the materials, many of which were incorporated in the RFP or other Solicitation materials. Bidders' conferences were held so that all interested parties had the opportunity to ask questions directly of the utilities as well as to identify any deficiencies in the Solicitation documents or supporting data. TEP scheduled one bidders' conference prior to the distribution of its Solicitation materials and APS conducted two. Bidders were invited to review non-proprietary materials produced by each utility and to address comments or inquiries to the utility, the Staff or the Independent Monitor regarding those materials at any time between the release of reports, plans or drafts and the submission of bids.

Throughout the Solicitation process, the Staff reviewed data, draft materials, and were kept advised of the Solicitation process. The Staff observed the Solicitation process, but did not participate in any decisions made by either utility.

The Staff, in conjunction with the Independent Monitor, reviewed the resource plans, the price and cost forecast, and the network transmission assessments prepared by the utilities and made available, as appropriate, to bidders. The Staff also reviewed energy and capacity forecast data provided by the utillities to interested parties and

compared it to the forecasts previously filed with the ACC when assessing system needs.

During the pre-Solicitation process, the Staff took responsibility for validating the data for each utility identifying the amount of capacity and energy that was subject to competitive procurement and developing the overall policy guidelines that controlled the scope, nature and timing of this Solicitation. The Staff reviewed the transmission capability assessments of APS and TEP to establish their accuracy. The Staff reviewed the methodology prepared by the utilities for evaluating bids to assure that all bids would be evaluated using common standards and methodologies. Also, the Staff was present at the opening of bids to confirm that all bids were treated equitably. However, neither the Staff nor the Independent Monitor had any role in the selection of bids that were accepted or in the negotiations of final contracts with any successful bidder. Further, neither the Staff nor the Independent Monitor determined whether the power supplies contracted for as a result of this Solicitation are appropriate, will be used and useful, or were reasonably or prudently acquired.

To assist the Staff and to assure all parties to the Solicitation for power supplies that the process employed was conducted in a transparent, effective, efficient and equitable manner, the Independent Monitor was appointed by the Staff and worked at the Staff's direction.

The Independent Monitor was responsible for:

- monitoring all communications regarding the Solicitation by and among the utility and any bidders or potential bidders;
- evaluating the adequacy, accuracy and completeness of all Solicitation materials, and the quality of the evaluations conducted;

- monitoring negotiations conducted by the utility and any bidder;
- keeping the Staff informed of the status and any significant developments during the Solicitation;
- advising the Staff and the utility of any issue affecting the integrity of the Solicitation process and providing the utility an opportunity to remedy the defect identified;
- periodically submitting informal status reports to the Staff on the Solicitation being conducted, noting any deficiencies identified in the preparation of Solicitation materials, maintenance of records, communications with bidders, or in evaluating or selecting bids;
- advising the Commission if significant issues compromised the integrity of the Solicitation;
- after bids were selected, preparing and submitting this report to the Commission detailing the Independent Monitor's observations and findings relating to the conduct of the Solicitation and any recommendations for improvements of the Solicitation process employed in the initial Solicitation.

The Independent Monitor had full access to all materials used in or relating to the Solicitation. Each utility made its personnel available for consultation with the Independent Monitor as requested. The Independent Monitor reviewed the evaluation of bids prepared by each utility and required that selected evaluations be rerun using alternative assumptions or definitions of bid terms. The Independent Monitor also monitored all negotiations conducted with bidders subsequent to the selection of bids.

As required, the Independent Monitor has previously submitted one status report and two preliminary final reports to the Commission and the Staff describing the progress made in executing this Solicitation noting any unresolved issues that could impair the equity or appropriateness of the Solicitation process. These reports are attached as Attachments 1 through 3.

III. DEFINITIONS OF PRODUCTS SOLICITED AND OFFERED

Bids for the following products were offered in the Track B RFP:

Standard Monthly Product(s)

- On Peak 6x16 – Blocks of firm energy delivered between 0700 to 2200 Pacific Prevailing Time (PPT) - 6 days/week (Monday through Saturday)
- Super Peak - Blocks of firm energy delivered between 1300 to 2000 PPT - 6 days/week (Monday through Saturday)
- Off Peak 7x8 - Blocks of firm energy delivered between 2300 to 00600 PPT - 7 days/week
- Round the clock 7x24 or ATC - Blocks of firm energy delivered 24 hours a day 7 days/week

These products were offered either with fixed or floating prices and are take or pay products.

Fixed Price

These products provide a guaranteed amount of energy at a fixed price. The contracted energy must be taken whether or not the purchaser has sufficient load to use this power. Energy deliveries in excess of load are sold in the hourly spot market at the current clearing price.

Indexed Price

These products provide a guaranteed amount of energy at a fixed heat rate based on an indexed gas price. The contracted energy must be taken whether or not the purchaser has sufficient load to use this power. Energy deliveries in excess of load would be sold in the hourly spot market at whatever the clearing price is. These products carry an additional risk of exposure to price changes in the gas market. This risk is often hedged through the purchase of financial products.

Non – Standard Products

- Daily Call Options. These products give the purchaser the right to purchase blocks of on-peak, off-peak or super-peak power on a day ahead basis. The daily call options provide significant flexibility in matching resources and needs. They were offered with a wide variety of terms including fixed and indexed pricing, firm and unit contingent reliability and super peak and shaping flexibility.
- Unit Contingent Dispatchable Products. This group of products represents the largest component of the capacity offered in the Track B solicitation. These products give the purchaser the right to dispatch the power output of a generating facility on an as needed basis subject to minimum load requirements and ramping restrictions based on the physical characteristics of the unit. The units bid in the Track B solicitation were priced using a guaranteed heat rate and indexed to gas prices delivered to the unit. The units also were offered with varying levels of guaranteed availability with financial penalties if the unit failed to perform at the promised levels.
    - Ramping is the rate at which the power output of a unit can be increased or decreased, and is a factor in determining the value of a product.

- Delivery point swaps. These products provide the buyer with the ability to increase its transmission flexibility by buying blocks of power at one location and selling equivalent amounts at another.

RMR Products

- Dispatchable capacity/energy. These products are dispatchable unit contracts for generating facilities located within the constrained load pocket in the Phoenix area.

IV. REVIEW PROCESS

The review process began in the pre-solicitation phase with the determination of the background system information needed by bidders and ended with the awarding of contracts. Both APS and TEP used the same basic solicitation process, an RFP. Because of the participation of an affiliate in the APS solicitation, there were differences in how each company structured their solicitation.

A. TEP

1. Schedule

TEP began the pre-solicitation preparation before the ACC issued Decision No. 65743, and initially planned to use the schedule agreed to by participants to the Track B workshops. As permitted by the Decision, TEP adjusted the solicitation schedule to accommodate the need of TEP and bidders for more time between the

release of the Decision and the release of the RFP. The schedule used by TEP was as follows:

February 28	Draft Documents Released
March 5	Bidders' Conference
March 17	RFP Issued for Products 1-8
April 4	Products 4-8 Received
April 23	Products 1-3 Received
April 24	Bid Evaluation Completed
April 25	Winners Notified
May 5	Contracts Signed

2. Bidders

TEP compiled a list of potential bidders from a number of sources. All companies that had provided energy to TEP before the Solicitation were included as potential bidders. All WSPP participants were added to the bidder list, as were any supplier that requested inclusion. The suppliers who participated in the Track B workshops were also included on the list of potential bidders. The list of potential bidders numbered 55 (Attachment 4). By design, TEP made the list as expansive as possible, without any attempt to qualify companies before including them as potential bidders.

TEP obtained contact information for all of the companies and directly contacted each to advise them of the Solicitation, and directed them to the Solicitation web site as the way to participate in the Solicitation.

3. Solicitation Web Site

TEP established a web site through which it provided information and documents to bidders. The web site was the medium for communication between TEP and bidders, with telephonic or personal contact restricted to the bidders' conference and the discussion of bidder-specific financial information. Bidder questions were posted on the web site, and were subsequently coupled with TEP's response to each question. This procedure provided all bidders with access to the same information, while avoiding exchanges between TEP and only one bidder.

The TEP web site was accessible to the public without the requirement of registration and any access permission. The company chose this approach after determining that all information posted on the web site was already publicly available. Attachment 5 contains sample TEP Solicitation web site pages.

4. Solicitation Documents

As discussed in the Independent Monitor's Pre-Solicitation Report (Attachment 1), information available to bidders included the Transmission Assessment, RMR Analysis, Needs Assessment, and the company's Ten-Year Resource Plan. These documents were available on the company's Solicitation web site and as public documents at the ACC. During the bidders' conference, the bidders agreed that the information was adequate for them to prepare bids designed to meet TEP's needs. TEP solicited bidders' reaction and suggestions about the system information to confirm that bidders had the background system information they needed. With the compilation of the system information completed, the company turned to preparing solicitation documents. TEP made draft documents available to the

Independent Monitor and bidders before the bidders' conference. Comments about the drafts were considered and discussed during the bidder conference, with the final documents reflecting a consensus among the participants.

TEP made available two standard industry agreements for use by the winning bidders. The Western System Power Pool Agreement (WSPP) (Attachment 6) and the Edison Electric Institute Agreement (EEI) (Attachment 7) were produced by the collaborative effort of market participants and provide standard terms, with clearly delineated subject areas that parties to an agreement negotiate. TEP expressed a preference for the WSPP Agreement, because currently, TEP uses that contract for most of its purchases. However, TEP expressed a willingness to use the EEI Agreement if a bidder preferred.

5. Bidders' Conference

TEP held a Bidders' Conference on March 5, 2003, in Phoenix. The conference was held at the same location and on the same day as the APS conference, but at a different time. This was done for the convenience of the bidders, and to encourage maximum participation. The Independent Monitor and the Staff attended the conference. The notice of the bidders' conference was posted on the web site and it was open to all potential bidders. There was no teleconference option for bidders, but the materials presented at the conference were posted on the web site. No bidder objected to this approach. Participants were requested to sign-in, but this was not mandatory, so participants could remain anonymous.

In addition to the draft RFP, TEP provided a summary of the RFP and had technical and business personnel present to answer questions. The draft RFP and solicitation schedule were discussed and suggestions exchanged. Also, provisions of

the WSPP and EEI contracts were discussed. It is noteworthy that the atmosphere was professional and congenial with TEP solicitous of input from all participants. Throughout the conference, TEP and bidders worked together to edit the draft RFP, set an agreeable schedule for the solicitation, and reached agreement on generic contract terms. TEP provided all information requested by bidders and agreement was reached on all terms and conditions for the RFP (Attachment 8).

6. Evaluation and Selection

TEP evaluated all bids on an equal and consistent basis. There was no attempt to disguise the identity of bidders, primarily because no TEP affiliate participated in the Solicitation. TEP evaluated all bids, including those for products that were not expressly solicited. The evaluation included the assessment of deliverability, price, creditworthiness, experience of the bidder, and the impact of proposed changes to the proposed WSPP or EEI agreements.

After eliminating one bidder for failure to pay the bid fee, TEP attempted to find value in the bids from the remaining five bidders. One bidder suffered from an inability to deliver to the TEP system, one bidder was substantially more expensive than the other bidders, and one bidder was not price competitive with alternate power sources available to TEP. Consequently, each was eliminated. TEP conducted negotiations with the remaining two bidders, PPL Energy Plus and Panda Gila River, and, ultimately, executed contracts with both. Copies of the contracts executed will be provided to the ACC by TEP.

B. APS

1. Schedule

In anticipation of Decision No. 65743, APS began assembling system information before the Decision was released. As the solicitation progressed, APS adjusted the schedule to accommodate the ACC requirements enumerated in the Decision and the time frames established. The schedule initially used by APS was as follows:

February 28	Pre-Solicitation Documents Released
March 5	First RFP Bidders Conference
March 19	Final Date for Written Comments and/or Questions on Documents
March 19	Second Bidders Conference
March 21	Final RFP and EEI Master Agreement Issued
March 28	Notice of Intent to Respond to RFP Due
April 4	Sealed Proposal(s) Due Date for Group A Bids and Group B Bids (excluding only pricing for fixed price Proposals)
April 24	Due Date for Submitting Pricing for Fixed Price Proposals for Group A Bids and Group B Bids
April 25	Withdraw Deadline for Fixed Price Group A and Group B Proposals
April 28	Begin to Notify Respondents of Short List (includes both Group A and Group B Bids)
April 28	Notification to Initial Successful Respondent(s) for Fixed Price Group A Bids and Group B Bids
April 28 – May 22	Final Evaluation Complete/Conduct Negotiations and Execute Contracts with Successful Respondent(s) for Other Group A and Group B Bids

July 1	Estimated Commencement of Service Under Contract

2. Bidders

APS included 60 potential bidders on its initial contract list, regardless of creditworthiness, states of their projects, or apparent transmission deliverability constraints (Attachment 9). APS directly contacted every company identified as a potential supplier to alert them to the Solicitation and directed them to the Solicitation web site as the way to participate and communicate.

3. Solicitation Web Site

APS established a web site through which it provided information and documents to bidders. The web site was the medium for communication between APS and bidders, with telephonic or personal contact restricted to the bidders' conference and the discussion of bidder-specific financial information. Bidder questions and responses from APS were posted on the web site. This procedure provided all bidders with access to the same information, while avoiding exchanges between APS and only one bidder. Access to the APS web site was restricted to the individuals who requested access and were provided with an identification and password. Attachment 10 contains sample APS Solicitation web site pages.

Initially, gaining access to the APS web site was needlessly cumbersome and created frustration for bidders, the Staff and the Independent Monitor. Once an individual requested access, APS insisted on talking to the person on the telephone before releasing the password necessary for access. Numerous parties were denied access for days while waiting for contact to be made. Rather than immediately posting

questions on its web site as asked by bidders, APS formulated responses to questions and then posted both the question and the answer. This often resulted in delays in responding to questions or in providing requested information. Ultimately, this situation was resolved before the RFP was issued.

4. Solicitation Documents

As discussed in the Independent Monitor's Pre-Solicitation Report, information available to the bidders included the Network Transmission Assessment, RMR Analysis, Load and Resource Plan, and the contestable load estimate produced by the Staff. These documents were available on the company's Solicitation web site and as public documents at the ACC. During the bidders' conference, the bidders agreed that the information was adequate for them to prepare bids. APS solicited bidders' reaction and suggestions about the system information to confirm that bidders had the background system information they needed. With the compilation of the system information completed, the company turned to preparing solicitation documents. APS made draft documents available to the Independent Monitor and bidders before the bidders' conference. Comments about the drafts were considered and discussed during the bidder conference.

APS chose to use the EEI Master Agreement (Attachment 11) for the Solicitation. The initial APS draft EEI Agreement elected some contract terms that were inconsistent with prevailing industry practices in the area of cross-collateral credit and credit assurances. Before releasing its final RFP (Attachment 12), APS agreed to provide cross collateral to bidders with superior credit rating to APS's, and to drop the initial demand for cash collateral from bidders with the credit rating equal to, or better

than, APS. Accordingly, APS revised its proposed EEI Master Agreement and posted it on the secure web site.

5. Bidders' Conferences

APS held two Bidders' Conferences, the first on March 5, 2003 and the second on March 19, 2003, in Phoenix. The Independent Monitor and the Staff attended both conferences, as did representatives of approximately twenty-five prospective bidders. The notice of the bidders' conference was posted on the web site and it was open to all potential bidders. There was no teleconference option for bidders, but the materials presented at the conference were posted on the web site. No bidder objected to this approach. Participants were requested to sign-in, but this was not mandatory, so participants could remain anonymous.

At the first bidders conference, APS provided a summary of the RFP and had technical and business personnel present to answer questions. The draft RFP, the solicitation schedule and provisions of the EEI contracts were discussed. The first bidders conference was a tense and contentious event, with bidders challenging numerous terms and provisions in the draft documents, and APS adopting a defensive posture. While many points of disagreement were identified, few issues were resolved. Because the range of disagreement was so vast, APS agreed to accept written comments and suggestions from bidders, and to conduct the second bidders' conference. Before the second bidders' conference, APS reviewed the suggestions received at the initial conference and through written submissions, along with any questions posted on the web site. A revised RFP, and EEI Master Agreement with modified credit requirements were posted on the web site before the second conference.

The second bidders' conference on March 19, 2003, was less contentious than the first. All issues were discussed and some resolved to the satisfaction of all parties. Though disagreements remained after the bidders' conferences, the conferences served the useful purpose of providing APS with additional suggestions to improve its documentation, many of which were adopted in APS' final RFP materials.

6. Evaluation and Selection

APS evaluated all bids in an equitable and consistent fashion including bids for products that were not expressly solicited. The evaluation included the assessment of deliverability, price, creditworthiness, experience of the bidder, and the impact of proposed change to the proposed EEI Agreement.

In order to demonstrate that the evaluation was not biased in favor of PWEC, an APS affiliate that submitted multiple bids in this Solicitation, APS with the assistance of the Independent Monitor attempted to devise a means for evaluating bids without identifying bidders. This proved impractical, principally because evaluation of bids required comparison of information that would identify the bidder. For example, once the delivery point, heat rate and generating unit description were disclosed, the bidder's Identity would be apparent.

Because "blind" evaluation was impractical, APS and the Independent Monitor restricted APS' access to PWEC's bids until other bids were evaluated and ranked. Sealed bids from all bidders were received on April 4, 2003, without pricing information. The Independent Monitor opened all bids, except those from PWEC, and released them to APS. The Staff witnessed the bid opening. APS then evaluated contract terms proposed by bidders and ran a system optimization study to establish the

appropriate portfolio mix of products to be acquired. Additionally, each bid was modeled using proxy pricing data. Only after these two reviews were completed did the Independent Monitor release the PWEC bid to APS. This approach minimized the temptation to adjust the evaluation model, after reviewing PWEC's bid. In fact, there was no indication that APS in any way attempted to develop evaluation criteria or methodologies that favored its affiliate.

On April 23, 2003, bidders submitted pricing data which was input to APS' evaluation model to establish the value of bids when compared to market costs. PWEC submitted a sealed bid, while other bidders were free to send prices of their bids by fax, email, or hand copy. All bidders had until close of business on Friday, April 24, 2003 to withdraw their bids, after which bids were considered firm. APS evaluated all bids, except PWEC against the market price established as of close of business Thursday April 24, 2003. The model was run with an artificial "place holder" set at market price for PWEC. Once this analysis was completed, APS delivered it to the Independent Monitor, the PWEC bid prices were then released to APS. The full analysis, including the PWEC bid prices, was completed and delivered to the Independent Monitor on the night of Sunday, April 27, 2003. The following day, APS accepted bids from PWEC and PPL Energy Plus for power for summer months in 2003 through 2006.

Subsequent to advising PWEC and PPL Energy Plus of APS' intent to accept one bid from each of them, APS invited certain other bidders to re-bid their offers for discrete and specific non-summer time frames at refreshed prices by April 30, 2003. Most of the parties replied to APS' request with responsive new bids. On May 1, 2003, APS selected two additional offers and commenced negotiations to finalize contracts

pursuant to those offers. APS was able to finalize one contract with Panda Gila River. Copies of the contracts executed will be provided to the ACC by APS.

V. BIDDERS AND BIDS RECEIVED

As a result of the RFPs issued by APS and TEP, each company received bids to meet their unmet needs and to provide power that potentially could meet RMR needs or displace energy and capacity that would otherwise have been provided by assets owned or controlled by the utilities. Bids also provided both companies the opportunity to assess whether power supplies offered would reduce the amount of economy power either company would need to acquire through purchases in the short-term or through bilateral contracts.

In total, APS received more than 175 bids from ten distinct bidders including:

- Pinnacle West Energy Co.
- PPL Energy Plus LLC
- Panda Gila River LC
- FPL Energy Inc.
- Reliant Energy
- Dome Energy
- Harquahala Generating Co.
- Powerex
- Shell Coral Energy
- UBS Warberg

Of those bids, only two bidders were disqualified for failing to pay the required bid fee. Several companies that had participated in the Track B proceeding and initially expressed an interest in bidding failed to submit bids.

Bids submitted to APS totaled more than 2750 MW of on-peak capacity in 2003 and up to 4073 MW in 2004. These bids were for products ranging from short-term daily call options to longer term unit commitments. Because bids were submitted

pursuant to confidentiality agreements (Attachment 13), a detailed description of the bids submitted is attached as Confidential Attachment 14 which is for the exclusive use of the ACC and its Staff.

TEP received bids from:

- PPL Energy Plus LLC
- Panda Gila River LC
- Southwest Power Group
- North Branch Energy
- APS
- Shell Coral Energy

totaling a maximum of almost 1000 MW of on-peak capacity by 2006.

As was the case for APS, one bidder was eliminated because it failed to remit the required bidder's fee.

Bids to TEP included call options, firm on-peak energy and both long and short-term unit contingent power. Unlike APS, TEP bifurcated the bid process and sought bids for standard products separately from bids for non-standard products.

TEP received no bids for standard products. We believe that bidders chose to wait until the Solicitation ended and will offer standard products to TEP through bilateral transactions or in open-market transactions, in part to avoid the payment of the bidder's fee. We believe this is the case since, in TEP's case, owing to the relatively small value of the contracts TEP was likely to execute, the bidder's fee could represent a significant portion of the seller's anticipated margin.

As in the APS case, bids were submitted pursuant to confidentiality agreements (Attachment 15). Accordingly, detailed descriptions of bids received are being provided to the ACC in Confidential Attachment 16.

VI. EVALUATION OF BIDS

A. APS

APS developed a comprehensive process for evaluating the bids received under the Track B process. There were three simultaneous efforts undertaken to reduce the population of shorter terms bids (bids for less than 4 years) to a short list. These three efforts were an evaluation of the individual bids on an economic basis compared to market without regard to the impact of the product in serving the load of APS customers. The second effort was a detailed review of each proposal for non financial factors. This included reviews of credit quality, deliverability, and reliability as well as assuring that all Commission requirements such as the environmental data had been met. The final effort in the preliminary review was an analysis of the resource needs of the system to determine the optimum amount of each product needed to meet the load requirements of APS customers. This provided input as to the quantity of a given product that would be taken. Longer term bids were evaluated against a self build option. This process will be discussed below.

1. Market Valuation Study

a. Forward Price Curves

The process used in the development of the forward curves for the Track B evaluation process is exactly the same as the process used in APS's normal course of business. The APS traders continually maintain and update forward curves for all relevant markets.

- Development of Forward Power Curves for Standard Block Power Products

These forward curves were developed using information from a variety of sources including electronic trading platforms (such as ICE and Bloomberg), OTC broker quotes, and transactions that APS entered into directly with wholesale counter parties. The forward curves were developed for the primary market trading hubs for standard firm products (6x16 on-peak and standard-NERC off-peak). The primary market trading hubs are Palo Verde, SP15 NP15 and Mid-Columbia. In addition, basis curves (representing the cost of delivery from primary to secondary hubs) were developed for each relevant secondary trading location.

- Development of Forward Natural Gas Price Curves

The process for the development of forward natural gas price curves was similar to that described above for electric price curves. All natural gas price curves were established by using the NYMEX futures contract prices as the underlying market value. The NYMEX futures settlement prices as of the market close on April 24, 2003, were used in the market evaluation studies. Forward basis curves for each natural gas delivery point (Permian, SoCal BDecision, NW Rockies, etc.) were developed by the APS natural gas traders using markets obtained from OTC broker quotes, electronic trading platforms, and direct contacts with counter parties.

The forward price curves for electric at Palo Verde and NYMEX gas futures are included in Confidential Attachment 17 to this report.

- Shaping Factors

Shaping factors were used to develop daily and hourly forward price curves from the monthly price curves developed above. These factors were

important for establishing the market value of any product that is not a standard market product. For example a super peak price curve (8 hours) was needed for valuing super peak products. A daily 16 hour on-peak price curve was needed for valuing any product that is a daily exercise option on the 16 hour on-peak block. An hourly power price curve was necessary to value any product which involves the hourly dispatch of power plants. In general these factors have been developed based upon historical market prices (daily and hourly spot market data sources such as Dow Jones index data, Energy Market Report, Gas Daily and California PX historical Trading data).

b. Market Valuation Methods

Several market valuation models were used to evaluate the different products bid through the Track B process. These valuation models are described below. The valuation models/methods used by APS for Track B are the same as those used in its normal course of business.

- Take-or-Pay Block Products

These products include 6x16 block products, standard off-peak block products, super peak block products, and 7x24 block products. For all these products, the energy volume is exactly known and the valuation is accomplished by calculating a weighted average energy value based on the monthly forward price curves and the monthly delivery volume.

- Daily Call Options

A daily call option valuation model was used to value these bids. This includes several different products including call options on 16 hour on-peak blocks and 7x24 blocks , differing types of strike prices (fixed or floating), and different reliability (firm or unit contingent).

- Dispatchable Power Plant Products

This third model used the hourly forward electric price curve and the daily natural gas price curves created using the shaping factors described above. The specific generating unit inputs such as heat rates, capacity limits, startup limits, startup costs, variable O&M costs, and variable gas transportation costs were key inputs to this model.

2. Risk Evaluation

APS conducted a review of all of the proposals to determine the relative risk of the proposals in six areas.

a. Contract Flexibility

In this area the Company analyzed two specific attributes. The first was the liquidity of the contract in terms of its delivery point, with major hubs like Palo Verde and SP15 receiving maximum scores of 10 and a sliding scale downward to a minimum score of 2 for less liquid hubs. The second flexibility criteria was the ability to shape delivery under the proposal. Here, dispatchable contracts received the high score of 10 and decreasing scores given to less flexible options. The two factors were then weighted equally to establish a weighted flexibility score based on the matrix shown below.

50% **Liquidity Rating**		**50%** **Shaping**
10	PV, SP15	10=Controlled Dispatchable
8	MEAD, FC	7=Day Ahead Preschedule
6	WW, PP, Lib,Rudd	5=Call Option
4	Jojoba,Gila 69, North Gila	3=All Others
2	OTHERS	

Flexibility scores ranged from a high of 10 to a low of 2.5

b. Contract Reliability

The next area of review was reliability. Here a base score for operational reliability was established with firm power receiving a maximum score of 10 with decreasing scores for lesser levels of reliability. Then the operational score was adjusted for two factors. The first was the firmness of gas supply and the second was an adjustment for historical record. The matrix below shows the scores and adjustments used to evaluate reliability.

Reliability Matrix	**Operational Availability**	**Gas Supply**	**Adjustments to Reliability**	**Historical Record**
10	Firm Power	Firm Transport	**0**	Commercial
8	Unit Contingent- 90%+ EAF	Alternative	**-1**	Test Mode
6	Unit Contingent- 80%-89% EAF	Interruptible	**-2**	Permitted under construction
4	Unit Contingent - 70% EAF or less	No physical transport	**-5**	Not Permitted
2	Non Firm			

The reliability scores ranged from a high of 10 to a low of 2.

c. Price Risk

The next risk that was evaluated was price risk. Here the high score was given to fixed price proposals and the lowest score given to floating price proposals for which there was no ability to hedge. A further adjustment was made to proposals for which the ability to hedge was present but had a medium or high risk that the hedge could be placed effectively. The matrix shown below was the basis for this review.

Score	Fixed/Float	Hedge	Risk
10	Fixed	0	Low
6	Float with Hedge	-1	Med
2	Float with no hedge	-2	High

The price risk evaluation resulted in scores ranging from 4 to 10.

d. Commitment Risk

The next area of risk that was evaluated was the level exposure in time of the proposed product and the extent to which the product provided for minimum block sizes and/or maximum hourly ramps. The longer the block of time the greater the exposure to loss as shown in the matrix below.

Commitment	Operational Response	Financial Impact	Schedule Flex	
10	Hour Ahead	Hour Ahead	0	No Ramping limits or block size
8	Day Ahead	Day Ahead	-2	Minimum Block Size of 25 MW with a maximum hourly ramp of 100 MW
5	Month Ahead	Month Ahead	-4	Minimum Block Size of 50 MW with a maximum hourly ramp of 50 MW

Commitment risk scores ranged from a high of 8 to a low of 2.5

e. Credit and Contract Risk

The final risk evaluation done by APS was an evaluation of the credit worthiness of the parties making the proposals and the extent to which the contract terms requested by APS were amended in the proposal. An overall credit score was

established based on the credit rating of the counterparty. Companies rated AA or better received a score of 10. The minimum starting score of 8 was given to companies who had no published credit ratings. From these base scores downward adjustments were made to the extent contract terms were changed in the proposal. Adjustments were made for elimination of the requirement for an independent amount, placing an overall cap on the amount of credit support allowed under the contract, modification to the definition of which credit rating to use ("higher" or "lower"), requiring bilateral credit, elimination of the "regulatory out" provision and other factors. Under this methodology credit and contract scores ranged from 1 to 10.

3. Short Term Bid Optimization Process

This step consisted of developing an optimized mix of bid products designed to meet APS' hourly load requirements in the least cost manner possible over the short term horizon of 2003-2005 assuming market prices. This optimized mix of products was then used as a guide in performing the final optimization of bids based upon prices received on April 24, 2003. The analytical tool employed in these analyses was an advanced production cost model known as RTSIM (Real Time Simulation).

Upon receipt of bid prices on April 24, 2003, a number of Track B scenarios were developed, each representing a combination of bid products and run through the RTSIM production costing model. Each scenario was developed with the multiple intent of (1) insuring each bid was modeled at least once in the analyses (2) the value of all non-PWEC bids was identified and (3) sufficient bid product combinations were created to identify the most economic portfolio of bids. An initial total of 14 scenarios were selected and evaluated for presentation to senior management on April

27, 2003 together with and complimentary to parallel economic one-off analyses performed by the front office.

Assumptions underlying the RTSIM base case used in the analyses were provided to the Independent Monitors on April 16. Changes implemented on April 24 at the start of the final analyses included an update of power and gas forward curves (fixed as of April 24), a surplus generation and purchase power sale criteria of 75% of economic opportunities for such sales, and a 1200 MW limit placed on hourly purchases and sales. Of critical importance in understanding the results of the system analyses performed with RTSIM is that the analyses were performed on a relative basis. All scenarios developed were compared against a base case which represented an unhedged and, therefore, under priced resource plan. The base case was adjusted to include PWEC's West Phoenix CC units 4 & 5 upon determination that no other options were available to meet APS' must run requirements.

According to APS, questions raised as a result of the meeting with senior management resulted in additional scenarios being created. A reevaluation of the system study results was undertaken to assess the new scenarios and the opportunity taken to correct those errors which had been identified following the presentation to senior management as well as to extend the evaluation through 2006. They were shared with and reviewed by senior management on April 30, prior to making final commitments to the successful bidders.

4. Supplementary Short List Bid Evaluation

The last step in the short term bid evaluation process was undertaken in support of the short list, supplementary bid process. Negotiations were

initiated with a short list of bidders soliciting bids to meet APS' non-summer month capacity and energy requirements. The RTSIM analysis performed consisted of 12 scenarios, most of which evaluated individual bid proposals. The same base case previously used in the Track B evaluation was used for this purpose with an update in forward power and gas prices. May 1 prices were used.

5. Analysis Of Long Term Bids

APS received bids for long term commitments from four bidders. These offers included proposals that extended in time for varying periods ending in 2026. APS used a separate long term model to evaluate these proposals. The basis of this analysis was the long term resource plan of the company and the methods and assumptions used were consistent with those used in the normal course of business and the analysis of the short term proposals in Track B.

a. Long Term Resource Plan

The base plan used for evaluation assumed that APS would use open market purchases through 2005 to meet any capacity shortfall. In 2006 the plan assumed that approximately 1700 MW of resources were to be added to the system. These resources include 1000 MW of combined cycle generation located near Palo Verde, 618 MW of combined cycle generation located in the transmission constrained area available for RMR needs, and 79 MW of combustion turbine generation with an undesignated location. (Note: This mix of resources is substantially equivalent to the resources offered by PWEC (Redhawk 1&2 – 990 MW at Palo Verde, West Phoenix 4&5 – 634 MW at West Phoenix, and Saguaro SC 3 – 79 MW at Saguaro).In addition, the long term plan added generic resources as follows:

Year	Simple Cycle	Combined Cycle	Base Load
2007	750		
2008	150		
2009		500	350
2010			
2011	150		
2012	150		
2013		500	200
2014			
2015	150		200
2016	300		
2017			300
2018		500	
2019			300
2020	300		
2021	600		300
2022	450		
Total	**3000**	**1500**	**1650**

Each of the proposals was evaluated against this base resource plan. Each long term bid was analyzed and compared to the cost of building the required capacity if the bid was for like assets. If no like assets were in the base case, the bid was compared to open market purchase prices developed by APS. Present Value differences were determined for ten, twenty, and thirty year periods for each bid. The result of the analysis indicated that on a stand alone basis some proposals demonstrated benefits in the ten and twenty year cases but none in the 30 year case. However, when the Track B purchases made to meet 2003 to 2006 load were considered none of the long term proposals had positive value during any period and therefore they were not selected.

6. Independent Monitor Conclusions Concerning The APS Analysis

In our opinion, the analyses were conducted in a fair and consistent manner and did not advantage or disadvantage any bid or bidder.

B. TUCSON ELECTRIC POWER

TEP developed a comprehensive process for evaluating the bids received under the Track B process. The first effort was an evaluation of the individual bids on an economic basis compared to market, generation by TEP's own units and, in the case of long term contracts, a comparison with TEP's estimates of its cost to build. This analysis was done without regard to the impact of the product in serving the load of TEP customers. From this analysis of the individual offers a short list was created and negotiations were undertaken. The final effort was an analysis of the selected products impact on meeting the load requirements of TEP customers. This second step provided input as to the quantity of a given product that would be taken.

1. Market Valuation Study

a. Forward Price Curves

The process used in the development of the forward curves for the Track B evaluation process was exactly the same as the process used in TEP's normal course of business. The TEP traders continually maintain and update forward curves for all relevant markets.

- Development of Forward Power Curves for Standard Block Power Products

The forward curves were developed using Natsource. The forward curves were developed for the primary market trading hubs for standard firm products (6x16 on-peak and standard-NERC off-peak). The primary market trading hubs are Palo Verde, SP15 NP15 and Mid-Columbia. In addition, basis curves (representing the cost of delivery from primary to secondary hubs) were developed for each relevant secondary trading location.

- Development of Forward Natural Gas Price Curves

The process for the development of forward natural gas price curves was similar to that described above for electric price curves. All natural gas price curves were established by using the NYMEX futures contract prices as the underlying market value. The NYMEX futures settlement prices as of the market close on 4/3/03 were used in the market evaluation studies. Forward basis curves for each natural gas delivery point (Permian, SoCal BDecision, NW Rockies, etc.) were developed by the TEP natural gas traders using markets obtained from OTC broker quotes, electronic trading platforms, and direct contacts with counter parties.

The forward price curves for electric at Palo Verde and NYMEX gas futures are included in Confidential Attachment 18 to this report.

- Shaping Factors

Shaping factors were used to develop daily and hourly forward price curves from the monthly price curves developed above. These factors were important for establishing the market value of any product that is not a standard market product. For example a super peak price curve (8 hours) is needed for valuing super

peak products. A daily 16 hour on-peak price curve is needed for valuing any product that is a daily exercise option on the 16 hour on-peak block. An hourly power price curve is necessary to value any product which involves the hourly dispatch of power plants. In general these factors have been developed based upon historical market prices.

b. Market Valuation Methods

Several market valuation models were used to evaluate the different products bid through the Track B process. These valuation models are described below. The valuation models/methods used by TEP for Track B are the same as those used in the normal course of its business.

- Take-or-Pay Block Products

These products include 6x16 block products, standard off-peak block products, super peak block products, and 7x24 block products. For all these products, the energy volume is exactly known and the valuation was accomplished by calculating a weighted average energy value based on the monthly forward price curves and the monthly delivery volume.

- Daily Call Options

A daily call option valuation model was used to value these bids. This included several different products including call options on 16 hour on-peak blocks and 7x24 blocks , differing types of strike prices (fixed or floating), and different reliability (firm or unit contingent).

- Dispatchable Power Plant Products

This third model used the hourly forward electric price curve and the daily natural gas price curves created using the shaping factors described above.

The specific generating unit inputs such as heat rates, capacity limits, startup limits, startup costs, variable O&M costs, and variable gas transportation costs were key inputs to this model.

2. Analysis Of Long Term Bids

TEP evaluated each of the long-term bids it received against a self-build option. The self-build option reflected construction costs estimated by TEP for appropriately sized generation to be added to its system based on TEP's current resource plan. None of the long-term bids received were competitive with TEP"s available alternatives.

3. Non-Economic Factors

While TEP evaluated the creditworthiness of each bidder and reviewed suggested changes to its proposed form of contract, those factors did not, ultimately, effect the decisions made by TEP. Each bidder provided sufficient data to qualify and all proposed contract changes were either acceptable to TEP or, in TEP's opinion, capable of resolution through negotiation.

4. Independent Monitor Conclusions Concerning The TEP Analysis

The Independent Monitor believes that TEP conducted a fair and consistent evaluation of all bids and its approach and method did not unduly advantage or disadvantage any bid or bidder.

VII. OBSERVATIONS RE DECISION PROCESSES EMPLOYED

Each utility approached this Solicitation in a manner that reflected its own unique needs and concerns. TEP's unmet needs were modest and it had a relatively small unhedged power position and it had no affiliate bidding. APS, on the other hand, had both significant unmet needs and a larger unhedged position. Additionally, the

likelihood that PWEC, its affiliate, would bid required APS to be able to clearly demonstrate that its affiliate was afforded no undue advantage. These factors significantly influenced the approaches to the procurement effort each company followed.

TEP's decision process was flexible and streamlined. Credit requirements were established which afforded all potential bidders an opportunity to participate. Evaluation procedures were concise and essentially required two steps to determine whether or not to short list a bid. The first was a high level review to determine whether the product offered was reliable. Owing to the nature of the bids received, this required a subjective as well as an objective evaluation of bids which proposed to provide services from plants which had not yet been constructed. The second step was to evaluate bid prices against a standard market price to rank order the value of the bids received. Once the short list was created, selected bids were run through TEP's standard dispatch model to establish the value of the bids and to determine any refinements to the offer that should be negotiated. To carry out this process, TEP assigned qualified staff who were able to present their results and to answer questions in a timely and appropriate manner. TEP was able to maintain this approach in large part because it neither anticipated nor got a large number of bids.

APS' decision-making process was far more complex. Initially, APS expended considerable effort to develop an optimized power supply portfolio. The purpose of that effort was to determine the specific types and quantities of power supply products APS should purchase. This effort was conducted prior to the submission of bids. Once bids were received, they were assigned to a particular product type and evaluated individually against a fixed market price developed by APS based on forward price

curves that it uses in the normal course of its business. Each bid, except for long-term bids, was assessed using the same evaluation model, and market price and gas price forward curve. Long-term bids were assessed against a self-build alternative developed by APS which reflected anticipated construction costs of units APS would build based on its long-term resource plan and a standard gas price forward curve. This process allowed APS to establish a short list to model using its standard load dispatch model. APS uses RTSIM as its dispatch model which, because of the number of bids received, proved to be a tool not well suited to support a decision making process that required fast data turnaround times and in the end, provided data that was only marginally more useful in evaluating the impact of choices made than the data produced during APS' comprehensive screening of bids.

In both TEP's and APS' Solicitations, the economics of the bids submitted was the only factor that ultimately determined the bids selected. As required by the Decision, both utilities required bidders to summarize environmental impact data with bids, and required the winning bidders to submit more comprehensive data concerning environmental issues. However, neither TEP nor APS used the environmental information in their evaluation. Although significant time and effort was expended in developing credit criteria and standard contract terms, both utilities found that they were able to accommodate each bidder's credit or contract language needs. The economic advantages of the bids selected were, however, so obvious that the subjective differences in value created by the alternate credit or contract terms proposed did not need to be assessed.

VIII. APS STANDARDS OF CONDUCT

Because PWEC indicated that it intended to bid in the APS solicitation, the separation of APS confidential data and personnel from its affiliates was of major concern throughout the Track B Solicitation. No similar concern arose during the TEP solicitation because from the outset TEP assured all parties that no TEP affiliate would bid in its Track B Solicitation.

From the viewpoint of bidders, confirmed separation was necessary to permit all bidders to compete on equal terms. For APS, it was necessary to develop adequate safeguards in order to establish that the company conducted an unbiased solicitation. From the prospective of the Independent Monitor, clear and confirmed separation of APS data and personnel from contact with any affiliate submitting a bid was a threshold indication of whether the solicitation was fairly conducted.

The ACC held that:

> [e]mployees of and contractors for APS's parent and affiliates, including but not limited to M&T, PWEC and Pinnacle West, who may be involved in the preparation of a bid in the solicitation process, shall not have contact with employees that will conduct the solicitation, concerning any business matter related to APS' parent or affiliates pertaining to the Track B Solicitation. Decision at 77.

The ACC observed that its Decision "shall [not] be construed as prohibiting APS, Pinnacle West, or PWEC officers and directors from providing corporate oversight, support and governance to their employees so long as such activities do not favor PWEC in Track B or provide PWEC with confidential bidding information during the Track B procurement that is not available to all other Track B bidders . . . ." Decision at

58. However, it noted that APS affiliates should seek "expertise that is dedicated to APS in the procurement process" from third party sources, rather than create "even an appearance of impropriety in the solicitation process" through the use of services shared among Pinnacle West companies. Decision at 58, 59.

As noted in the Pre-solicitation Report, during the pre-solicitation phase of this Track B process, APS established protocols to ensure that the evaluation of bids would be conducted in an equitable and auditable fashion. In order to accomplish this, APS set up a team of personnel who would conduct the process and would refrain from any communication with any other Pinnacle West personnel, including and especially, personnel from PWEC, on any matter relating to this solicitation. Attachment 19. Concurrently, PWEC also established a team to prepare any bid it chose to submit to APS. Attachment 20. APS also prepared a written set of Standards of Conduct (Attachment 21) that were published on the Solicitation web site. To see that the Standards of Conduct were understood within the corporation. APS appointed one attorney with responsibility for provided training throughout the corporation to all employees, other than PWEC personnel. PWEC employees received training in the Standards of Conduct from their own counsel to avoid direct contract with personnel, even lawyers, who would interact with the APS bid team. We were advised that all employees who had any possibility of being in contact with the APS bid team received instruction on behavior under the Standards of Conduct. The Independent Monitor reviewed the APS training materials and found them to be reasonable and appropriate. Attachment 22 illustrates the Pinnacle West organization as structured during the Track B Solicitation.

Pinnacle West has established several functions as “shared services” throughout its organization. The existing “shared services” design employed by Pinnacle West proved to be a continuing source of potential conflict during the solicitation. In some areas, such as human resources, the sharing of services was inconsequential and quite apart from the APS solicitation. The sharing of dispatch services provided an opportunity for the exchange of confidential information. That potential problem was avoided by full disclosure of system specifics to all bidders, However, under the Pinnacle West structure, PWEC and APS remained linked in two areas significant to the solicitation, legal services and risk management.

During the pre-solicitation phase, APS was insensitive to the potential appearance of impropriety created by allowing its lawyers to advise both APS and PWEC. The ACC’s recognition of the need to provide “corporate oversight” was presented as the reason to exempt lawyers from the rigorous standards applied to all other employees. At the strong urging of the Independent Monitor, an attorney was assigned to advise PWEC during the solicitation. That lawyer was prohibited from advising APS during the Solicitation period. Similarly, we were assured that all Pinnacle West attorneys would be subject to the Standards of Conduct during the solicitation. This arrangement was maintained during the solicitation process and satisfied the ACC directives.

Risk management, another shared service, was not as easily dealt with. APS needed risk management authorization before accepting a bid. PWEC needed risk management authority before bidding. Pinnacle West operates as one risk pool, with authority for risk tolerance established by the Pinnacle West Board of Directors. Accordingly, individual business units do not at this time have individual risk limits.

Initially, both APS and PWEC intended to use the risk management services provided by APS as a shared service during the solicitation process. Thus, in order to do their work the personnel advising both companies would have required access to confidential information that could not be made available to other bidders. Since virtually every member of the Pinnacle West risk management group provided direct or indirect assistance to APS in the risk management assessment of all bids, no employees were sufficiently segregated to advise PWEC without creating a potential conflict.

To deal with this situation, prior to the receipt of bids from any bidder, PWEC was isolated from, and did not rely on the Pinnacle West risk management shared services. Instead, PWEC received advice and authorization for each bid it tendered from the Chief Financial Officer of Pinnacle West who was not involved directly with the APS bid team.

This arrangement was awkward and disadvantageous to PWEC. At the same time it provided sufficient safeguards for the Track B Solicitation, but does not represent a practical long term solution. Unless Pinnacle West restructures its shared services organization, this will continue to be a source of potential conflict any time PWEC would be bidding against non-affiliated suppliers.

IX. SUGGESTED PROCESS IMPROVEMENTS

The Track B Solicitation process, while comprehensive and well designed, presents several opportunities for improvement. While most problems encountered proved insignificant and were easily solved, some approaches unduly complicated the process and added unnecessary time, effort and inflexibility to the utilities' normal business processes and therefore warrant review.

1. Bid Fee

Bid fees are frequently used in competitive Solicitations, though not in all Solicitations. Participants to the Track B workshops agreed that any bid fee should be applicable to each bidder, as opposed to each bid, and recognized the Track B Solicitation would require APS and TEP to incur additional costs. Most bidders were willing to pay the $10,000 bid fee, but some did not. Two bidders submitted bids, but failed to provide the requisite bid fee. Both companies were given additional days to submit the bid fee, but chose to be disqualified rather than pay the fee.

From our discussion with bidders, we believe other potential bidders may have elected not to participate because of the bid fee. Some of these bidders either have or had contracts to supply APS or TEP that were arranged bilaterally, without a bid fee. Some may have chosen to wait until the Solicitation was over and to then deal with the utilities bilaterally because the bid fee represented a disproportionately large percentage of their anticipated profit margin.

We believe the bid fee was reasonable as applied, that is, each bidder paid one bid fee. At the same time, APS and TEP may have received more competitive bids if there had been no bid fee. In future solicitations, it may be appropriate to eliminate bid fees for all bids for short-term standard products.

2. Regulatory Out

APS proposed the inclusion of a “Regulatory Out” provision in all contracts with power deliveries after 2005. The provision permits APS or bidders to terminate a Track B power supply contract in the event of certain regulatory actions or inactions. This provision appears to have been acceptable to the marketers that submitted bids.

However, it was identified as one reason some bidders chose not to provide bids for power to be supplied after 2005.

PWEC, one of the few bidders offering supplies beyond 2005, accepted the Regulatory Out provision, but, for purposes of its firm energy bid, it required a risk premium for energy contracted through the year 2006. PWEC offered prices for 2006 power that differed, depending on whether the Regulatory Out clause was included in the contract. By PWEC's calculation, the risk premium associated with the Regulatory Out provision for a firm energy commitment through 2006 was $28 million . PWEC's firm energy bid was not among the bids accepted by APS.

Prior to any future solicitation, the ACC should determine whether it will permit the use of Regulatory Out clauses in mandated solicitations.

3. Bidder Certificate

The ACC Decision required each bidder to certify it would not engage in unlawful market manipulation, and that the ACC may terminate a contract and exclude the bidder from future solicitations if it violates this pledge. Further, the certificate needed to be signed by the bidder's Chief Financial Officer (CFO). This requirement created considerable concern among bidders, due to a misunderstanding of the scope and intent of the requirement. APS required bidders to execute a separate Bidder Certificate (Attachment 23), and TEP included the commitment in the body of the RFP bidders were required to sign.

Most bidders agreed to a verbatim recitation of the Decision requirement, while expressing reservations. One potential bidder expressly declined to bid because of uncertainty of what obligations could flow from agreeing to the Decision requirement, as drafted. At least two bidders submitted bids without the signature of their CFO, while

others submitted bids with the understanding that clarification would be available before contracts would be executed. Release of a Federal Energy Regulatory Commission (FERC) Staff Report on market manipulation, after the Decision was issued, added to the confusion. The principal concern of bidders was a desire to avoid creating a dispute between FERC and the ACC concerning jurisdiction to determine market manipulation, and whether the ACC would attempt to rescind a contract retroactively to the date of execution.

With the assistance of the Staff, the Independent Monitor provided clarification of the ACC requirements. The clarification assured bidders that the ACC required FERC's authority to determine market manipulation, and that the ACC would only act after a FERC determination. Also, the Independent Monitor clarified that the ACC would only terminate contracts prospectively from a determination of unlawful market manipulation. Finally, the Independent Monitor confirmed that certification by the most senior officer of a bidder's company was acceptable, and that the absence of an officer holding the title of CFO was not a barrier to executing a contract. Prior to future solicitations, the Commission should clarify the scope and intent of the required Officer's Certification.

4. Procurement Freeze

APS and TEP were required to procure their unmet needs for 2003 through the Track B Solicitation process before contracting for or otherwise hedging their needs through bilateral contracts or open market transactions. When the Track B process became more protracted than expected, the utilities found themselves unable to take advantage of market opportunities even as they foresaw market prices rising.

We have not identified lost opportunities from this approach, and we appreciate the legitimate reasons for requiring the concurrent solicitation of all needs.

Only through a comprehensive, open-ended, solicitation could the utilities test, and the ACC evaluate the ability of a competitive solicitation process to create market opportunities for meeting system needs. In the future however, we believe that ongoing solicitations, whether through RFP's or other auction methods, should not limit a utility's ability to enter into appropriate power supply arrangements through open market transactions or to execute bilateral contracts in arm's length transactions, with non-affiliated suppliers. Transactions with affiliated suppliers should, however, remain subject to objective and transparent competitive procurement processes.

5. Future TEP Solicitations

Owing to TEP's relatively small unmet needs for the next 3 years and the transmission constraints of its system, TEP's requirements may be best met with Standard Products procured in open market transactions.

We believe TEP has in place the expertise and experience to procure system needs without a comprehensive solicitation, and without continual monitoring. Further, we believe it appropriate for the ACC to revisit TEP's procurement practices at the time the utility undertakes the analysis of whether to build generation to meet future needs. The utility forecasts the need for one 75 MW RMR unit in 2008 and another 75 MW RMR unit in 2017.

FINAL REPORT
OF ACCION GROUP, INC.,
INDEPENDENT MONITOR
IN THE
TRACK B SOLICITATION

ATTACHMENTS

1. Independent Monitor Pre-Solicitation Status Report
2. Independent Monitor Preliminary Final Report - APS
3. Independent Monitor Preliminary Final Report - TEP
4. List of potential bidders - TEP
5. TEP web site pages
6. Master WSPP Agreement - TEP
7. Master EEI Agreement - TEP
8. TEP RFP
9. List of potential Bidders - APS
10. APS web site pages
11. Master EEI Agreement - APS
12. APS RFP
13. APS Confidentiality Agreement
14. APS Bid Details -- CONFIDENTIAL
15. TEP Confidentiality Agreement
16. TEP Bid Details -- CONFIDENTIAL
17. APS Forward Curve and Gas Futures - CONFIDENTIAL
18. TEP Forward Curve and Gas Futures – CONFIDENTIAL
19. APS Solicitation Team
20. PWEC Bid Team
21. APS Standards of Conduct
22. Pinnacle West Organization Chart
23. APS Bidder Certificate